

Graduating Into Debt

How to budget for student loan payments

If you're one of the millions of college graduates leaving college with a degree in one hand and a stack of student loans in the other, you will want to read what the Michigan Association of CPAs has to say about the importance of planning for the repayment of your student loan.

STEP 1 - UNDERSTANDING YOUR LOAN

To fulfill your repayment obligation and build a strong credit history, you need to understand the terms of your student loan, develop a realistic budget, choose the right repayment option and make timely payments. Colleges generally conduct exit interviews with seniors during which a financial aid counselor reviews the student's total indebtedness, the repayment options available and when repayment begins. Most loans give you six months of breathing room, but some require that you begin repayment immediately.

STEP 2 - BUDGET, BUDGET, BUDGET

Good financial planning starts with sound budgeting. To determine how much you can afford to pay toward your debt each month, you will need to compute your income and expenses. In terms of estimating your income, be sure to take into account that the pay you are quoted is not what you will be taking home. Taxes and a variety of other payroll deductions, such as medical insurance, are going to result in a paycheck that may be considerably less than you expected.

Once you have determined your take-home income, you can realistically predict your monthly payments. Add up your living expenses such as rent, utilities, food, car and transportation expenses, and recreation. If you're not sure where you spend your money, you might want to keep a written record of your expenses over a few months. Student loan borrowers are typically advised to keep their monthly student loan payments within eight to ten percent of their monthly incomes. This guideline ensures that borrowers have enough discretionary income to cover other living expenses, as well as an occasional pizza or movie.

In addition to paying off your debt, CPAs emphasize the importance of saving some portion of your pay each month. It doesn't have to be a lot, but it should be regular. Once you've done that, it's not too early to start thinking about saving for retirement.

STEP 3 - CHOOSE A REPAYMENT OPTION

Your loan balance and interest rate determines your monthly payment amount. As a general rule, you can plan on paying about \$125 per month for every \$10,000 you borrow. The repayment options available to you depend on the type of loan you have.

Most borrowers choose the standard 10-year equal-installment plan that requires you to make payments of equal amounts over a maximum of ten years. This plan carries the highest monthly payment, but costs less over the long term because you pay less interest. Students who cannot meet the monthly payments required by the standard repayment plan may choose the graduated payment or income-sensitive plan. With a graduated payment plan, your payments start out low and rise every few years, on a fixed schedule. This option makes sense if you are just starting out in a career and expect your income to increase steadily. Another option, the income sensitive plan, adjusts annually to reflect changes in your income. CPAs recommend that you avoid stretching out the term of your loan unless it is absolutely necessary that you do so. While flexible payment options reduce your monthly payment, adding extra years to your loan means you will pay more interest over the life of the loan.

STEP 4 - MAKE TIMELY PAYMENTS

Once your repayment period begins, it is important that you make regular payments. Failure to do so may result in a ruined credit rating, substantial collection cost and lost opportunities in employment and in purchasing a car or a home. If you are having trouble making your payments, it is important to contact your lender. Most lenders are willing to work with you to make repayment easier. You may be eligible for a deferment, which allows you to put off payment for a while if you are unemployed, returning to school, or on parental leave. If you don't qualify for a deferment, you may be able to postpone payment through a forbearance. Under a forbearance, the lender allows you to stop making payments for a short period of time (though the interest on your loans will continue to accrue). Another option, consolidation, affords you the opportunity to lower your monthly payment by consolidating your loans and extending the term of your loan up to 30 years.

CPAs point out that as a result of a recent change in tax law, there's one more step you'll need to take and this one will save you money. Student loan borrowers with income may be able to deduct all or part of the interest paid on qualified student loans. This deduction is available whether or not you itemize. Only interest paid during the first 60 months in which interest payments are required is deductible.